

will also deter new competitors from entry.<sup>122</sup> Furthermore, the ILECs "could come up with a deeply discounted, very long-term discount that would appeal only to" the ILEC-affiliated IXC. Sprint at 44. Even if these discounts were offered to other carriers, the ILEC could tailor these offerings to the needs of its own affiliates, and competing carriers may be wary of entering long-term agreements in a dynamic emerging competitive environment.

USTA's assertion that consumers are better off if the ILECs can prevent customer loss to CLECs through the use of volume and term discounts because joint and common costs are borne more evenly (Schmalensee and Taylor at 30-31 (USTA)) is also flawed in a number of respects. First and foremost, the long-run prices that would emerge in a competitive market would allow for recovery of these costs because they are costs an efficient entrant would incur. Baumol/Ordover/Willig (Appendix A). Second, volume and term discounts allow incumbents to deter entry by lowering costs below competitive levels through cross-subsidies from noncompetitive markets. This threat may discourage firms which are even more efficient from entering. And it will certainly discourage equally efficient competitors.

**3. Contract Tariffs.** There is a similarly widespread consensus among the commenters that the ILECs should not be able to offer contract tariffs. These tariffs, which usually contain both volume and growth discounts, would allow ILECs to engage in predatory pricing and erect barriers to entry and to discriminate in favor of their affiliated IXC carrier. See, e.g., ACTA at 18-19.

As MCI points out (at 61-62), the availability of contract tariffs would enable the ILECs, because of their significant market power, to price discriminate in favor of their affiliated IXC carriers, even if the ILECs faced substantial competition. Although the Commission has established a goal of explicitly associating switched access charges with costs, "there is a serious risk that contract tariffs and RFPs may not be cost based, since the Commission's requirements of cost

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<sup>122</sup>ACC Long Distance at 7-8 (allowing incumbents to provide volume and term discounts on access will enable them to target medium and large businesses, which are traditionally the first customers a competitive provider targets).

justification under ICBs may provide no meaningful opportunity to ensure that rates are fair, non-discriminatory, and not predatory in effect.” TCG at 45.

As Sprint points out (at 45), the fundamental problem with contract tariffs is this: If an ILEC has the ability to provide contract tariffs, it will be able to tailor that tariff, in a discriminatory manner, to meet the particular needs of the ILEC-affiliated IXC. “The requirement that a tariff be ‘generally available to similarly situated customers under substantially similar circumstances’ is insufficient. It ignores the fact that tariffs are easily constructed so that only one user is positioned to adopt them, even if ostensibly offered to all.” MCI at 61-62.<sup>123</sup>

The Commission should prohibit ILECs from providing these tariffs until there is substantial competition.<sup>124</sup> The Commission's "startling" proposal to allow such tariffs in the absence of competition will severely inhibit the ability of CLECs to compete effectively with the ILECs. Time Warner at 33. If the Commission is attempting to address “the pressure placed on rates by network prices, the proper remedy is cost-based rate restructuring and rebalancing, not the freedom to selectively drop rates for targeted customers.” *Id.* at 31-32.

**4. New Services.** The commenters also agree that the Commission should not deregulate new services at this time. Deregulation of new services would allow ILECs to discriminate in favor of their affiliates -- the ILECs would be able to repackage existing services into a “new” service and then offer it at a discount on restrictive terms such that the new service

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<sup>123</sup>U S WEST nevertheless maintains that the ILECs should be permitted to offer contract tariffs because AT&T was given this flexibility in the IXC market before the Commission found AT&T to be a non-dominant carrier. In fact, AT&T had authority to use contract tariffs only for services for which the Commission found that there was substantial competition. See In re Competition in the Interstate Interexchange Marketplace, CC Docket No. 90-132, 6 FCC Rcd. 5880, 5894 (1991) (Commission found business services market to be competitive and thus allowed AT&T to file business service contract tariffs); see also In re Competition in the Interstate Interexchange Marketplace, CC Docket No. 90-132, 8 FCC Rcd. 3668, 3671-72 (1993).

<sup>124</sup>“[A] significantly greater level of competitive entry is necessary to prevent the use of contract tariffs strictly for entry deterring and predatory purposes. Contract carriage provides the incumbent LEC with unfettered pricing flexibility, giving it the opportunity to disrupt competition in the access market.” MCI at 60; see also Kwoka at 21 (MCI) (“Protections such as the requirement that there be “constraining competition” should be imposed to prevent the use of contract tariffs strictly for entry deterring or predatory purposes.”).

would be available only to the affiliate. Additionally, the deregulation of new services "would allow an ILEC to label unbundled pieces of pre-existing services as 'new.' The ILEC could then quickly establish uneconomic rates for the unbundled pieces of various 'old' services upon which new entrants must rely to provide service. This would drive up the new entrants' costs and harm competition." <sup>125</sup>

**5. High Cap and Special Access.** The commenters also uniformly reject ILEC arguments that special access services are competitive and therefore eligible for forbearance.<sup>126</sup> The CAP providers simply do not present the type of substantial competition to ILECs that the Act envisions and requires; instead, CAPs "provide only high capacity services to a limited number of customers in a limited number of buildings in the largest cities." MCI at 64. Thus, any "competitive" market created by the presence of CAPs exists in isolated pockets,<sup>127</sup> and is unable to produce widespread benefits to consumers in any significant geographic area.<sup>128</sup> If the Commission elected to remove special access services from price caps and tariff regulation, this would clearly

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<sup>125</sup>Time Warner at 33-34. As MCI has noted (at 62-63), "the price capped firm can offer a scarcely different 'new' service outside the cap at a price that attracts most customers from the original capped service. This results in a very low demand weight on the latter, so that its price may thereafter be increased without much adverse effect on other capped prices. That, in turn, allows the price of the unregulated service outside the cap to increase to near-monopoly levels."

<sup>126</sup>With regard to special access services, the NPRM "lacks any information or conclusions regarding the degree of competition that exists, including quantification." API at 37; see also California at 10 ("The concept of eliminating price regulation of high-capacity special access services is based on the unsubstantiated contentions of ILECs that there is already of [sic] "intense competition" for these services").

<sup>127</sup>SpectraNet at 5 ("Although competition is clearly increasing for high-capacity access, it is patchwork and sporadic at best."); cf. California at 10 ("California has experienced significant competition for transport services in recent years, but only in particular geographic areas.").

<sup>128</sup> As MCI points out (at 68), "Even in areas where a CAP is present, businesses that are not located in buildings served by the CAP cannot easily substitute the CAP's services for the LEC's services. As a result, the LEC could exercise significant market power over customers not on the CAP's network." Further, as the Pennsylvania Internet Service Providers note (at 17), "it is not enough to have just one or two alternative providers in an area. As we have seen repeatedly in other areas, replacing a monopoly with an oligopoly does not guarantee that the market will work competitively. Indeed, it is very likely that . . . consumers will lose the protection of regulation without receiving the benefits of competition. This is the worst of both worlds and must be avoided."

enable "the incumbent LEC to discriminate unreasonably between users" (MCI at 68) and, worse, to erect barriers to entry such as the kind of price squeeze discussed above.

6. **Directory Assistance.** The argument by several ILECs that the provision of Directory Assistance is already competitive, and thus eligible for immediate forbearance, is also misguided. Contrary to arguments by SNET and CBT, for example, the availability of directory information from sources such as the Internet and CD ROMs does not render these services competitive. For example, the availability of printed directories from a non-ILEC publisher does not provide competition for an ILEC's operator-provided directory assistance. Such printed directories provide a different service, which may marginally impact consumption of the ILEC's directory assistance service, but in no way provides substantial competition for that service. Accordingly, the cited alternate sources for the information provided by directory assistance is insufficient to support the ILECs' claim that these services are eligible for forbearance.

7. **Differential pricing.** The Commission should also decline to allow ILECs to engage in differential pricing across customer classes. It is likely that competition will develop in certain customer classes before others. Through the use of differential pricing, an ILEC would be able to use a noncompetitive class to cross-subsidize a competitive one. As the Texas PUC points out (at 20), such cross-subsidization would disproportionately harm residential customers -- as that class of customers is not likely to become competitive until after business classes do -- and would impede the development of competition.

In sum, for all these reasons, the ILECs should not be given additional pricing flexibility until they can demonstrate the *existence* of genuine competition, regardless of which overall approach the Commission adopts to reforming access charges.

**D. The Wide Variety Of Approaches Endorsed By The Commenters Clearly Illustrates The Need For the Commission To Conduct A Separate Rulemaking On The Appropriate Prerequisites For Additional Pricing Flexibility.**

In all events, the sheer complexity of the debate between ILECs and their customers on the propriety of additional pricing flexibility confirms and illustrates the need for the Commission to conduct a separate rulemaking on the appropriate prerequisites for relaxing price cap regulation. The commenters agree that it is premature to establish the criteria for evaluating the competition

faced by incumbent LECs, because no one can predict how the access market will evolve, or even if competition will ultimately be successful.

To the extent, however, that the Commission wishes to adopt any metrics in this proceeding, any such scheme must require significant facilities-based competition. The commenters agree that "anything short of meaningful facilities-based competition is ephemeral." TRA at 17; see also Ohio Consumers' Counsel at 2; API at 18; Time Warner at 27.

Moreover, the Commission should not fall into the trap set by the ILECs that advocate criteria that would "presumptively" find competition where none exists at all. For example, Ameritech (at 29) urges the Commission to hold that "demand-elasticities are presumptively high" because all that buyers require is a functionally equivalent alternative and they will readily switch due to small price changes. Demand responsiveness at inflated prices, however, is not the relevant inquiry because even a profit maximizing monopolist sets prices where demand is elastic. Baumol/Ordover/Willig (Appendix A). What is relevant is demand responsiveness at competitive and near competitive prices. These are the prices that an efficient firm might offer and to which incumbent LECs would respond.

In all events, demand responsiveness will likely be so low that widespread entry will remain futile in most markets for many years. First, anticompetitive practices -- including price and non-price behavior -- by the ILEC may improperly render competitive alternatives inferior. Absent a substantial alternative facilities-based provider, a CLEC will still be dependent on the ILEC in providing service to the customer, a condition the ILEC remains capable of exploiting to its advantage. Second, the presence of term contracts, which would be more prevalent under the expanded regulatory flexibility proposed at Phase 1, seriously hampers demand responsiveness. Finally, the availability of an alternative supplier for a single building in a major metropolitan area certainly does not justify the conclusion that other businesses or residential consumers also have similar price sensitivities. Their perceptions about quality as well as name brand loyalty may make them less price responsive. For all these reasons, it would be more reasonable to presume low demand responsiveness until the ILEC has clearly demonstrated otherwise.

Similarly, supply elasticity must not be treated in a cavalier fashion. The existence of an interconnection agreement or statement of generally available terms does not address the various barriers to entry discussed above. Furthermore, under USTA's time table, entry might not occur for up to two years, and even then fail to constrain prices. Supply responsiveness must actually exist, not simply be wished into existence.

In this regard, it is telling that the ILECs discourage the Commission from considering pricing trends and market share in assessing the level of competition. Their market shares far exceed that possessed by AT&T when the Commission chose to continue substantial price cap regulation. Moreover, if the ILECs are correct in their assessment of probable competitive effects, then pricing trends should follow a downward path. Indeed, that is the basis for their claim that market forces are sufficient to produce efficient prices. Their attempts to deflect the Commission from examining pricing trends strongly suggests that market forces will not adequately constrain incumbent behavior.

### CONCLUSION

For these reasons, the Commission should adopt a policy of reinitializing price caps rather than a "market-based" approach to access charge reform, decline to give the ILECs additional pricing flexibility until genuine competition has been demonstrated, and adopt the other measures described above.

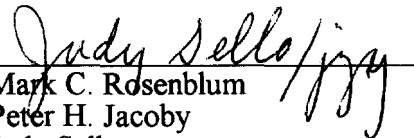
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Respectfully submitted,

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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of  
  
Access Charge Reform

CC Docket No. 96-262

**Reply Affidavit of Patricia D. Kravtin, Lee L. Selwyn and Joseph W. Laszlo**

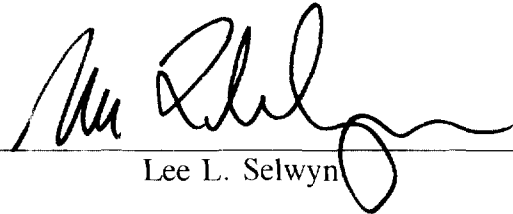
1. Our names are Patricia D. Kravtin, Lee L. Selwyn and Joseph W. Laszlo, Vice President—Senior Economist, President and Senior Analyst, respectively, of Economics and Technology, Inc, One Washington Mall, Boston, Massachusetts 02108. Economics and Technology, Inc. (ETI) is a research and consulting organization specializing in telecommunications economics, regulation and public policy. Our Statements of Qualifications appear as Attachments A, B and C to this reply affidavit. We submit this reply affidavit in response to the Commission's Notice of Proposed Rulemaking (NPRM) in CC Docket No. 96-262, Access Charge Reform, released December 24, 1996.

2. We prepared the attached report entitled "Reply to Incumbent LEC Claims to Special Revenue Recovery Mechanisms" on behalf of AT&T. The facts and analyses presented therein are true and correct to the best of our knowledge, information and belief.

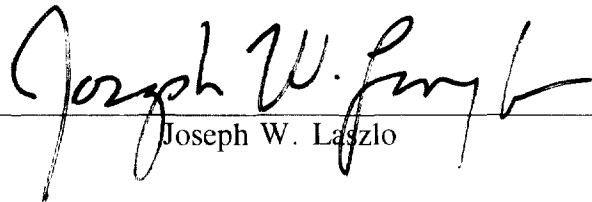
The foregoing statements are true and correct to the best of our knowledge, information and belief.



Patricia D. Kravtin



Lee L. Selwyn



Joseph W. Laszlo

## **Attachment A**

### **Statement of Qualifications**

#### **PATRICIA D. KRAVTIN**

Patricia D. Kravtin is Vice President and Senior Economist at ETI. Ms. Kravtin did graduate study in the Ph.D. program in Economics at the Massachusetts Institute of Technology, where she was a National Science Foundation Fellow. Her fields of study have included Industrial Organization, Government Regulation of Industry, and Urban and Regional Economics. While at M.I.T., Ms. Kravtin performed research for the Sloan School of Management and the Joint Center for Urban Studies of M.I.T. and Harvard. Her own empirical work has centered on multiproduct industries and has included econometric estimation of multiproduct cost functions and measurement of product-specific economies of scale and economies of joint production.

While in Washington, D.C., Ms. Kravtin gained valuable insight into the regulatory process performing research and policy analysis at the United States Department of Commerce, the Securities and Exchange Commission, and the Private Radio Bureau of the Federal Communications Commission.

Since joining ETI in 1982, Ms. Kravtin has been actively involved in telecommunications regulatory proceedings in state jurisdictions throughout the country and has frequently testified as an expert witness before regulatory commissions. Ms. Kravtin has testified before the Rhode Island Public Utilities Commission, the Maine Public Utilities Commission, the Florida Public Service Commission, the New York Public Service Commission, the Louisiana Public Service Commission, the Minnesota Public Utilities Commission, the Mississippi Public Service Commission, the Arizona Corporation Commission, the Kentucky Public Service Commission, the Delaware Public Service Commission, the Georgia Public Service Commission, the Tennessee Public Service Commission, the New Hampshire Public Utility Commission, the New Jersey Board of Regulatory Commissioners, the Arkansas Public Service Commission, the Kansas Corporation Commission, and the California Public Utilities Commission. Ms. Kravtin has also testified as an expert witness in anti-trust litigation before the United States District Court for the Eastern District of Tennessee at Greeneville.

Ms. Kravtin's assignments have involved the analysis of both rate design and revenue requirements issues. She has performed analyses of various cost methodologies used by telephone companies to determine costs and set rates, and econometric demand models used to develop estimates of repression and stimulation of demand as a result of price changes. She has conducted numerous analyses of the costs and benefits of local measured service.

Ms. Kravtin has also been involved in the analysis of issues relating to telephone company modernization expenditures and plant utilization. Ms. Kravtin has presented testimony on the subject of infrastructure/plant modernization before the Ohio General Assembly senate select Committee on telecommunications Infrastructure and Technology and the New Jersey Senate Transportation and Public Utility Committee.

More recently, Ms. Kravtin has gained extensive expertise in the area of video and multimedia information service markets. Ms. Kravtin has submitted numerous filings before the FCC

concerning the economics of video dialtone investment and/or VDT tariffs proposed by New Jersey Bell, Pacific Bell, Ameritech, Southern New England Telephone, US West, GTE, Bell Atlantic, BellSouth, NYNEX, Puerto Rico Telephone Company and Carolina Telephone in over 25 Section 214 Application proceedings. Over the past year, Ms. Kravtin has actively participated in a number of proceedings relating to the implementation of local competition pursuant to federal and state legislation, covering such topics as universal service, cost of basic service, interconnection, unbundling of network elements, and tariff development for new entrants.

Ms. Kravtin has authored and co-authored numerous papers and reports pertaining to these issues. These include the following:

"The Economic Viability of Stentor's 'Beacon Initiative,' Exploring the extent of its financial dependency upon revenues from services in the Utility Segment," prepared for Unitel, submitted as evidence before the Canadian Radio-television and Telecommunications Commission, March 1995.

"A Public Good/Private Good Framework for Identifying POTS Objectives for the Public Switched Network" prepared for the National Regulatory Research Institute, October 1991;

"The U S Telecommunications Infrastructure and Economic Development," presented at the 18th Annual Telecommunications Policy Research Conference, Airlie, Virginia, October 1990;

"An Analysis of Outside Plant Provisioning and Utilization Practices of US West Communications in the State of Washington," prepared for the Washington Utilities and Transportation Commission, March 1990; and

"Telecommunications Modernization: Who Pays?," prepared for the National Regulatory Research Institute, September 1988.

Ms. Kravtin has also been actively involved in the analysis of issues relating specifically to industry structure, BOC market power and MFJ restrictions, regulatory reform, price caps regulation, access charges, and local and long-distance competition in the telecommunications industry at both the state and federal level. Ms. Kravtin has served as an expert witness in antitrust cases involving BOC monopolization. She has co-authored numerous papers and reports pertaining to these issues. These include the following:

"Analysis of Incumbent LEC Embedded Investment: An Empirical Perspective on the 'Gap' between Historical Costs and Forward-looking TSLRIC," Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, submitted in FCC CC Docket 96-98, May 30, 1996.

"Reply to X-Factor Proposals for the FCC Long-Term LEC Price Cap Plan," prepared for

the Ad Hoc Telecommunications User Committee, submitted in FCC CC Docket 94-1, March 1, 1996.

"Establishing the X-Factor for the FCC Long-Term LEC Price Cap Plan," prepared for the Ad Hoc Telecommunications User Committee, submitted in FCC CC Docket 94-1, December, 1995.

"Fostering a Competitive Local Exchange Market in New Jersey: Blueprint for Development of a Fair Playing Field," prepared for the New Jersey Cable Television Association, January 1995.

"The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers," February 1994.

"A Note on Facilitating Local Exchange Competition," prepared for E.P.G., November 1991;

"Testing for Effective Competition in the Local Exchange," prepared for the E.P.G., October 1991;

"Report on the Status of Telecommunications Regulation, Legislation, and modernization in the states of Arkansas, Kansas, Missouri, Nebraska, Oklahoma and Texas," prepared for the Mid-America Cable-TV Association, December 13, 1990;

"Sustainability of Competition in Light of New Technologies," presented at the Twentieth Annual Williamsburg Conference of the Institute of Public Utilities, Williamsburg, Virginia, December 1988;

"Industry Structure and Competition in Telecommunications Markets: An Empirical Analysis," presented at the Seventh International Conference of the International Telecommunications Society at MIT, July 1988;

"Market Structure and Competition in the Michigan Telecommunications Industry," prepared for the Michigan Divestiture Research Fund Board, April 1988;

"Impact of Interstate Switched Access Charges on Information Service Providers - Analysis of Initial Comments," submitted in FCC CC Docket No. 87-215, October 26, 1987;

"An Economic Analysis of the Impact of Interstate Switched Access Charge Treatment on Information Service Providers," submitted in FCC CC Docket No. 87-215, September 24, 1987;

"Regulation and Technological Change: Assessment of the Nature and Extent of Competition From A Natural Industry Structure Perspective and Implications for Regulatory

Policy Options." prepared for the State of New York in collaboration with the City of New York, February 1987;

"Long-Run Regulation of AT&T: A Key Element of a Competitive Telecommunications Policy," *Telematics*, August 1984;

"BOC Market Power and MFJ Restrictions: A Critical Analysis of the 'Competitive Market' Assumption," submitted to the Department of Justice, July 1986; and

"Economic and Policy Considerations Supporting Continued Regulation of AT&T," submitted in FCC CC Docket No. 83-1147, June 1984.

Ms. Kravtin attended George Washington University on an Honor Scholarship where she received a B.A. with Distinction in Economics. She was elected to Phi Beta Kappa and Omicron Delta Epsilon in recognition of high scholastic achievement in the field of Economics. Ms. Kravtin is a member of the American Economic Association.

## **Attachment B**

### **Statement of Qualifications**

#### **DR. LEE L. SELWYN**

Dr. Lee L. Selwyn has been actively involved in the telecommunications field for more than twenty-five years, and is an internationally recognized authority on telecommunications regulation, economics and public policy. Dr. Selwyn founded the firm of Economics and Technology, Inc. in 1972, and has served as its President since that date. He received his Ph.D. degree from the Alfred P. Sloan School of Management at the Massachusetts Institute of Technology. He also holds a Master of Science degree in Industrial Management from MIT and a Bachelor of Arts degree with honors in Economics from Queens College of the City University of New York.

Dr. Selwyn has testified as an expert on rate design, service cost analysis, form of regulation, and other telecommunications policy issues in telecommunications regulatory proceedings before some forty state commissions, the Federal Communications Commission and the Canadian Radio-television and Telecommunications Commission, among others. He has appeared as a witness on behalf of commercial organizations, non-profit institutions, as well as local, state and federal government authorities responsible for telecommunications regulation and consumer advocacy.

He has served or is now serving as a consultant to numerous state utilities commissions including those in Arizona, Minnesota, Kansas, Kentucky, the District of Columbia, Connecticut, California, Delaware, Maine, Massachusetts, New Hampshire, Vermont, New Mexico, Wisconsin and Washington State, the Office of Telecommunications Policy (Executive Office of the President), the National Telecommunications and Information Administration, the Federal Communications Commission, the Canadian Radio-television and Telecommunications Commission, the United Kingdom Office of Telecommunications, and the Secretaria de Comunicaciones y Transportes of the Republic of Mexico. He has also served as an advisor on telecommunications regulatory matters to the International Communications Association and the Ad Hoc Telecommunications Users Committee, as well as to a number of major corporate telecommunications users, information services providers, paging and cellular carriers, and specialized access services carriers.

Dr. Selwyn has presented testimony as an invited witness before the U.S. House of Representatives Subcommittee on Telecommunications, Consumer Protection and Finance and before the U.S. Senate Judiciary Committee, on subjects dealing with restructuring and deregulation of portions of the telecommunications industry.

In 1970, he was awarded a Post-Doctoral Research Grant in Public Utility Economics under a program sponsored by the American Telephone and Telegraph Company, to conduct research on the economic effects of telephone rate structures upon the computer time sharing industry. This work was conducted at Harvard University's Program on Technology and Society, where he was appointed as a Research Associate. Dr. Selwyn was also a member of the faculty at the College of Business Administration at Boston University from 1968 until 1973, where he taught courses in economics, finance and management information systems.

Dr. Selwyn has published numerous papers and articles in professional and trade journals on the subject of telecommunications service regulation, cost methodology, rate design and pricing policy. These have included:

"Taxes, Corporate Financial Policy and Return to Investors"  
*National Tax Journal*, Vol. XX, No.4, December 1967.

"Pricing Telephone Terminal Equipment Under Competition"  
*Public Utilities Fortnightly*, December 8, 1977.

"Deregulation, Competition, and Regulatory Responsibility in the Telecommunications Industry"  
*Presented at the 1979 Rate Symposium on Problems of Regulated Industries - Sponsored by: The American University, Foster Associates, Inc., Missouri Public Service Commission, University of Missouri-Columbia, Kansas City, MO, February 11 - 14, 1979.*

"Sifting Out the Economic Costs of Terminal Equipment Services"  
*Telephone Engineer and Management*, October 15, 1979.

"Usage-Sensitive Pricing" (with G. F. Borton)  
(a three part series)  
*Telephony*, January 7, 28, February 11, 1980.

"Perspectives on Usage-Sensitive Pricing"  
*Public Utilities Fortnightly*, May 7, 1981.

"Diversification, Deregulation, and Increased Uncertainty in the Public Utility Industries"  
*Comments Presented at the Thirteenth Annual Conference of the Institute of Public Utilities*, Williamsburg, VA - December 14 - 16, 1981.

"Local Telephone Pricing: Is There a Better Way?: The Costs of LMS Exceed its Benefits: a Report on Recent U.S. Experience."  
*Proceedings of a conference held at Montreal, Quebec - Sponsored by Canadian Radio-Television and Telecommunications Commission and The Centre for the Study of Regulated Industries, McGill University, May 2 - 4, 1984.*

"Long-Run Regulation of AT&T: A Key Element of A Competitive Telecommunications Policy"  
*Telematics*, August 1984.



"Is Equal Access an Adequate Justification for Removing Restrictions on BOC Diversification?"

*Presented at the Institute of Public Utilities Eighteenth Annual Conference, Williamsburg, VA - December 8 - 10, 1986.*

"Market Power and Competition Under an Equal Access Environment"

*Presented at the Sixteenth Annual Conference, "Impact of Deregulation and Market Forces on Public Utilities: The Future Role of Regulation"*

*Institute of Public Utilities, Michigan State University, Williamsburg, VA - December 3 - 5, 1987.*

"Contestable Markets: Theory vs. Fact"

*Presented at the Conference on Current Issues in Telephone Regulations: Dominance and Cost Allocation in Interexchange Markets - Center for Legal and Regulatory Studies Department of Management Science and Information Systems - Graduate School of Business, University of Texas at Austin, October 5, 1987.*

"The Sources and Exercise of Market Power in the Market for Interexchange Telecommunications Services"

*Presented at the Nineteenth Annual Conference - "Alternatives to Traditional Regulation: Options for Reform" - Institute of Public Utilities, Michigan State University, Williamsburg, VA, December, 1987.*

"Assessing Market Power and Competition in The Telecommunications Industry: Toward an Empirical Foundation for Regulatory Reform"

*Federal Communications Law Journal, Vol. 40 Num. 2, April 1988.*

"A Perspective on Price Caps as a Substitute for Traditional Revenue Requirements Regulation"

*Presented at the Twentieth Annual Conference - "New Regulatory Concepts, Issues and Controversies" - Institute of Public Utilities, Michigan State University, Williamsburg, VA, December, 1988.*

"The Sustainability of Competition in Light of New Technologies" (with D. N. Townsend and P. D. Kravtin)

*Presented at the Twentieth Annual Conference - Institute of Public Utilities Michigan State University, Williamsburg, VA, December, 1988.*

"Adapting Telecom Regulation to Industry Change: Promoting Development Without Compromising Ratepayer Protection" (with S. C. Lundquist)

*IEEE Communications Magazine, January, 1989.*

"The Role of Cost Based Pricing of Telecommunications Services in the Age of Technology and Competition"

*Presented at National Regulatory Research Institute Conference, Seattle, July 20, 1990.*

"A Public Good/Private Good Framework for Identifying POTS Objectives for the Public Switched Network" (with Patricia D. Kravtin and Paul S. Keller)  
Columbus, Ohio: *National Regulatory Research Institute*, September 1991.

"Telecommunications Regulation and Infrastructure Development: Alternative Models for the Public/Private Partnership"  
*Prepared for the Economic Symposium of the International Telecommunications Union Europe Telecom '92 Conference, Budapest, Hungary, October 15, 1992.*

"Efficient Infrastructure Development and the Local Telephone Company's Role in Competitive Industry Environment" *Presented at the Twenty-Fourth Annual Conference, Institute of Public Utilities, Graduate School of Business, Michigan State University, "Shifting Boundaries between Regulation and Competition in Telecommunications and Energy", Williamsburg, VA, December 1992.*

"Measurement of Telecommunications Productivity: Methods, Applications and Limitations" (with Françoise M. Clottes)  
*Presented at Organisation for Economic Cooperation and Development, Working Party on Telecommunication and Information Services Policies, '93 Conference "Defining Performance Indicators for Competitive Telecommunications Markets", Paris, France, February 8-9, 1993.*

"Telecommunications Investment and Economic Development: Achieving efficiency and balance among competing public policy and stakeholder interests"  
*Presented at the 105th Annual Convention and Regulatory Symposium, National Association of Regulatory Utility Commissioners, New York, November 18, 1993.*

"The Potential for Competition in the Market for Local Telephone Services" (with David N. Townsend and Paul S. Keller)  
*Presented at the Organization for Economic Cooperation and Development Workshop on Telecommunication Infrastructure Competition, December 6-7, 1993.*

"Market Failure in Open Telecommunications Networks: Defining the new natural monopoly." *Utilities Policy*, Vol. 4, No. 1, January 1994.

*"The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers,"* (with Susan M. Gately, et al) a report prepared by ETI and Hatfield Associates, Inc. for AT&T, MCI and CompTel, February 1994.

*"Commercially Feasible Resale of Local Telecommunications Services: An Essential Step in the Transition to Effective Local Competition."* (Susan M. Gately, et al) a report prepared by ETI for AT&T. July 1995.

"Efficient Public Investment in Telecommunications Infrastructure"  
*Land Economics*, Vol 71, No.3, August 1995.

"Market Failure in Open Telecommunications Networks: Defining the new natural monopoly," in *Networks, Infrastructure, and the New Task for Regulation*, by Werner Sichel and Donald L. Alexander, eds., University of Michigan Press, 1996.

Dr. Selwyn has been an invited speaker at numerous seminars and conferences on telecommunications regulation and policy, including meetings and workshops sponsored by the National Telecommunications and Information Administration, the National Association of Regulatory Utility Commissioners, the U.S. General Services Administration, the Institute of Public Utilities at Michigan State University, the National Regulatory Research Institute at Ohio State University, the Harvard University Program on Information Resources Policy, the Columbia University Institute for Tele-Information, the International Communications Association, the Telecommunications Association, the Western Conference of Public Service Commissioners, at the New England, Mid-America, Southern and Western regional PUC/PSC conferences, as well as at numerous conferences and workshops sponsored by individual regulatory agencies.

## **Attachment C**

### **Statement of Qualifications**

#### **JOSEPH W. LASZLO**

Joseph W. Laszlo is a Senior Analyst at ETI. His main areas of interest include telecommunications regulatory policy and economics; advanced network technology and modernization; and international telecommunications policy and development.

Mr. Laszlo has contributed extensively to the research and writing of a number of ETI consulting projects and research papers. In the area of the regulation of telecommunications services, Mr. Laszlo has contributed to projects including: evidence presented before the Canadian Radio-Television Telecommunications Commission concerning price caps; testimony on cost allocation submitted to the Idaho Public Utilities Commission in a 1996 US West rate case; and a study of the imputation of Yellow Pages revenues for the support of universal service. Mr. Laszlo's work on advanced technology has included: contributing to a study refuting BOC claims regarding the impact of the growth of Internet usage on the public-switched telephone network; research for a report on the potential impact of the universal service provisions of the 1996 Telecommunications Act on educational institutions, which was presented at a National Regulatory Research Institute Conference; and analysis of the availability and pricing of frame relay services.

Mr. Laszlo joined ETI in 1996 upon receiving a Master of Arts in Law and Diplomacy from The Fletcher School of Law and Diplomacy in Medford, Massachusetts (jointly administered by Tufts and Harvard Universities). At the Fletcher School, Mr. Laszlo concentrated in the fields of international trade and finance, technology policy, and business and economic law. He worked as Business Manager of *The Fletcher Forum of World Affairs*, the official journal of the Fletcher School, and also as a teaching assistant in the Fletcher economics department. Prior to attending the Fletcher School, Mr. Laszlo received his A.B., *Magna Cum Laude*, from Columbia University. He has also studied at the Stanford Japan Center in Kyoto, Japan.

**REPLY TO INCUMBENT LEC  
CLAIMS TO SPECIAL REVENUE  
RECOVERY MECHANISMS:**

In the Matter of  
Access Charge Reform

CC Docket No. 96-262

Patricia D. Kravtin  
Lee L. Selwyn  
Joseph W. Laszlo

February 14, 1997



ECONOMICS AND TECHNOLOGY, INC.

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	USTA/ILEC arguments are based fundamentally upon application of rate of return regulation concepts no longer applicable under price cap regimes.	4
	The majority of plant currently carried on the ILECs' books is relatively new, i.e., acquired on or after January 1, 1990.	5
	For digital switching plant categories, 75% of ILEC historical book investment as of the end of 1996, was acquired on or after January 1, 1990.	6
	Beginning January 1, 1990, if not earlier, ILECs were well aware of and had ample opportunity to actively manage ongoing investment and construction planning to reflect the emerging competitive market environment.	7
	USTA/ILEC arguments assume that capacity, technology, and customer requirements driving ILEC investments are based on the provision of basic local exchange and exchange access service, when in fact a significant amount of ILEC investment must be explained by <i>other</i> than demand growth for basic service.	9
	A substantial portion of ILEC historical book investment, some \$30-billion, corresponding to \$9-billion in estimated annual costs, cannot be explained by basic service demand growth over the 1990 to 1996 period.	9
	Investment data for Year End 1996 provided in ILEC comments provides validation for ETI's projections and serves to confirm the accuracy of ETI's study methodologies and the results derived therefrom.	11

*Reply to Incumbent ILEC Claims to Special Revenue Recovery Mechanisms*

USTA and the ILECs have not demonstrated a cost causative link to basic local exchange or exchange access services for plant currently on the ILECs' books. 12

USTA/ILEC arguments ignore or discount other revenue sources available to the ILECs for recovery of embedded plant which must be taken into account in assessing the need for special recovery mechanisms. 13

Relatively high ILEC market-to-book values, premiums over book value in recent ILEC merger agreements, and estimates of new revenue opportunities all belie ILEC claims of capital recovery problems. 14

At least one ILEC - SNET - acknowledges that the correct economic framework for evaluating capital recovery includes consideration of revenue opportunities, but then inappropriately assumes away such opportunities in its own reserve deficiency analysis. 15

RBHC arguments that interLATA revenues should not be taken into account in offsetting access charge reductions are patently unreasonable, given the *quid pro quo* established in the Act and the realities of their new competitive operating environment. 16

ILEC statements that seek to diminish the significance of revenue opportunities associated with the sale of additional residential access lines are contradicted by ILEC marketing activities, investment reports, public statements by top ILEC officials, and ILEC outside plant provisioning practices. 18

USTA/ILEC arguments assume the ILEC embedded base of copper cable and digital switching plant is declining in value and rapidly becoming obsolete, despite documented technological advances demonstrating that these important categories of ILEC embedded plant are both useful and valuable, and will likely remain so into the foreseeable future. 20

TFI fails to tie its theories of technology substitution to the specific issues relating to ILEC claims of special revenue recovery raised in this proceeding 20

The SPR Study's reports of the death of the existing network infrastructure are greatly exaggerated. 22

The SPR Study's arguments that cable and wire (and in particular copper cable) are practically worthless totally ignores the current deployment of digital communications technology in the loop which makes the continued use

of copper cable viable in the long term. 23

Far from being “obsolete,” modern digital switches are designed to be easily and regularly upgraded, giving them new and expanded functionality at a fraction of the cost of purchasing an entirely new switch. 28

The SPR Study is factually wrong in its assertion that any likely network changes will render existing digital switches obsolete. 29

Several final examples demonstrate that the expense of purchasing entirely new switches is so great that it is almost always more efficient to upgrade existing switches. 32

3 CONCLUSION 35



# 1 | INTRODUCTION AND SUMMARY

This Reply responds to comments submitted by USTA and incumbent local exchange companies (ILECs) pertaining to empirical issues raised in the NPRM concerning the difference between historical embedded costs and forward-looking costs, and associated ILEC claims to special revenue recovery mechanisms. As discussed in this Reply, the arguments presented by USTA and the ILECs fail to support their claims for special revenue recovery.

The arguments advanced by USTA, ILECs, and their numerous experts do not directly respond or refute evidence presented by AT&T and others. That evidence showed that much of the difference between the revenues generated by access prices based upon embedded costs as compared to forward-looking costs is the result of strategic overbuilding of plant and/or inefficiencies, both of which were and are within the control of ILEC management. Despite allegations of underrecovery, the ILECs have presented no evidence that prices set at forward looking cost for exchange access services, coupled with new revenue opportunities, will not fully compensate them for their historical network expenses.

USTA's and the ILECs' initial presentation to the Commission can be characterized as largely unsupported assertions around two major themes:

- (1) That ILEC investments were made prudently pursuant to regulatory compacts and in fulfillment of universal service obligations. Accordingly, the ILECs assert these investments represent "legitimate costs of doing business" for which the ILECs are entitled full recovery through special recovery mechanisms.
- (2) That major categories of ILEC embedded plant, principally copper cable and digital switching, are experiencing a major decline in economic value due to obsolescence. This purported decline in economic value and imminent obsolescence in turn produces sizable depreciation reserve deficiencies for which the ILECs assert an entitlement to full recovery through special recovery mechanisms.